

SEPARATE TAXATION

EXHIBIT NO. 2

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ANNUAL REPORT 2005



Partnering



www.bluecrossmontana.com

OUR VISION

To be the health plan of choice for Montanans

OUR MISSION

To excel as an innovative leader in providing for more Montanans access to high-quality health care through affordable coverage.

OUR VALUES

Customer Focus

We fulfill our external and internal customers' expectations by offering services in a prompt, efficient, and pleasant fashion. We continually seek to gain a clearer understanding of our customers' needs.

Quality and Excellence

We continually work to improve our processes and eliminate unnecessary steps or expenses. We are committed to producing outstanding results. We will participate in continuous learning, so we can make informed decisions.

Integrity and Compliance

We are committed to being trustworthy and honest and to performing our jobs ethically and in compliance with all applicable laws.

Trust

We will create a work environment based on trust, concern, and open communication - one that builds positive relations and respects others' opinions.

Social Responsibility

We are active in community involvement efforts, especially in areas related to improving health and providing accessibility of health care to everyone.

Open Communication

We provide clear, timely, and accurate information about the organization to all employees at all levels. We will establish conduits for a two-way flow of information.

2005: YEAR AT A GLANCE

Partnering to Provide Alternatives

Through a number of partnerships, BCBSMT provides Montanans with many alternatives for health insurance coverage.

Children's Health Insurance Program (CHIP)

Through a partnership between the Montana Department of Health and Human Services and BCBSMT, low-income uninsured Montana children up to the age of 18 receive basic health insurance coverage at no cost.

InsureMontana

Through a partnership with the State of Montana and the Montana Department of Insurance, BCBSMT offers group coverage to previously uninsured small Montana businesses as the result of bipartisan legislation passed in 2005.

Montana Comprehensive Health Association (MCHA) Premium Assistance Program

The MCHA Premium Assistance Program allows more lower-income Montanans with high-risk medical conditions to have health benefits. This program is the result of a partnership that includes BCBSMT, the State of Montana, the Montana Comprehensive Health Association Board, the Montana Department of Insurance, Montana's Congressional delegation, and Montana medical professionals and hospitals.

Montana Business Group (Association) Insurance Pools

Montana businesses, have been able to gain economies of scale through insurance pools or association plans. Partnerships among employers' business associations, the health benefit agent and consultant communities, and BCBSMT have launched successful health insurance programs, allowing more cost-effective health plans, predictability in rate changes over time, and choice of benefits and provider networks. Through these pool partnerships, employers who previously did not offer employee coverage can now do so.

Caring Program for Children – Caring Foundation of Montana

Through a partnership among BCBSMT, the Montana medical community, and donors throughout the state, uninsured Montana children who fall between the cracks of government programs and private health insurance have access to primary and preventive health benefits at no cost to their families.

During 2005, the Company:

- Named Sherry Cladouhos President and CEO.
- Partnered with six other Blue Plans to form the Northern Plains Alliance, a regional consortium offering Medicare Advantage and Medicare Part D coverage to Medicare-eligible citizens.
- Teamed up with the Mayo Clinic to offer Well With BlueSM a worksite health and wellness program.
- Recognized by the Centers for Medicare and Medicaid Services, for the second year in a row, as the Medicare contractor with the lowest error rates in the nation.
- Partnered with the Helena Indian Alliance to enhance services provided through the Leo Pocha Clinic.
- Named the Corporate Citizen of the Year by the American Indian Business Leaders (AIBL).

PARTNERING WITH MONTANA'S MEDICAL COMMUNITY

Blue Cross and Blue Shield of Montana believes that maintaining a robust provider network is vital to affordable healthcare. Partnering with medical professionals and hospitals across the state, we offer the most extensive networks in Montana. Our two largest networks are the Traditional Network and the HealthLink Network.

TRADITIONAL NETWORK

Approximately 1,800 physicians, 59 hospitals and more than 200 other health care facilities, and over 2,500 non-physicians health care professionals participate in the BCBSMT traditional network. The only cost to BCBSMT members using this network is any copayments and deductibles.

HEALTHLINK

Our hospital-based preferred provider organization (PPO) network is the largest in the state. Through it, our members have access to 52 hospitals, 14 surgical centers, and all the medical professionals in the Traditional Network.

FINANCIALS

BALANCE SHEET

Assets

	2005	2004
Cash and Short-Term Investments	\$ 32,522,692	\$ 30,730,105
Member Dues and Other Receivables	56,095,537	26,782,257
Prepaid Expenses	1,999,617	2,464,695
Long-term Investments	148,003,682	144,904,468
Property and Equipment, Net of Accumulated Depreciation	20,437,128	20,300,803
TOTAL ASSETS	259,058,656	225,182,328

Liabilities and Reserves

Liabilities

Provision for Unreported Claims	\$ 58,230,327	\$ 39,729,681
Unearned Member Dues	16,058,642	11,994,807
Other Liabilities	76,191,286	75,646,340
TOTAL LIABILITIES	150,480,255	127,370,828

Reserves

Total Other Comprehensive Income (Loss)	499,161	(4,534,167)
Unassigned Reserves	108,079,240	102,345,667
TOTAL RESERVES FOR PROTECTION OF SUBSCRIBERS	108,578,401	97,811,500
TOTAL LIABILITIES & RESERVES	259,058,656	225,182,328

Statement of Operations

Net Revenues	\$ 536,425,534	\$ 511,921,015
Expenses		
Health Care Services	472,970,775	447,600,804
Special Projects Including HIPAA	5,486,884	5,142,958
General and Administrative, Net	54,020,565	55,476,455
Assessment and Other Regulatory Fees	3,660,910	3,455,405
Investment and Other (Income) Expense	(4,938,503)	(3,247,650)
Income Tax	(640,953)	1,436,313
Cumulative Effect of Change in Accounting Principle		(914,687)
Unrealized (Gains) Losses on Securities, net of tax	(810,079)	(2,200,145)
Minimum Pension Liability, net of tax	(4,090,966)	1,465,187
TOTAL EXPENSES	525,658,633	508,214,640
TOTAL COMPREHENSIVE INCOME	\$ 10,766,901	\$ 3,706,375

2005 was a challenging and exciting year for Blue Cross and Blue Shield of Montana – challenging because health care costs, and in turn, insurance costs, continued an upward trend, but exciting because we forged new partnerships and strengthened relationships that will ultimately help us achieve our mission. That mission is to provide access for more Montanans to high-quality health care through affordable coverage.

Montana ranks ninth in the nation for its uninsured population. Approximately 19% of all Montanans are uninsured and that creates a vicious cycle. Costs to care for the uninsured are passed on to those with insurance, which increases the cost of insurance, which causes more people to become uninsured. Our goal is to break that cycle by reducing the number of uninsured Montanans.

We cannot accomplish that goal by ourselves. We must work collaboratively with our stakeholders – our groups and members, the Montana medical community, regulators and legislators, and the Montana business community. Working together, we can give more Montanans the peace of mind and security that comes with health insurance coverage.

Looking back at 2005, I see progress. For the fifth consecutive year, BCBSMT provided coverage for the Children's Health Insurance Program, which provides insurance coverage to more than 12,000 low-income, uninsured Montana children. BCBSMT was awarded the contract for InsureMontana, a state program through which small employers can receive premium assistance or tax credits by providing health coverage for their employees. Through the Caring Foundation of Montana, over 5,000 uninsured Montana children received basic preventive health care services.

Blue Cross and Blue Shield of Montana has a great team of professionals, dedicated to serving Montanans, and willing to accept the challenges before them. I am very proud to have the opportunity to work with them and with all our stakeholders to help our fellow Montanans.

Sincerely,

Sherry L. Cladouhos

Sherry L. Cladouhos
President and CEO



LEADERSHIP

BOARD OF DIRECTORS

Jerry Lusk, Board Chair

Kalispell

Sharon Archambeault, Gallagher,
Archambeault & Markles, PC

Glasgow

Jimmie Ashcraft, M.D., *Billings*

Lane Basso, President, Stratus Consulting, Inc.

Billings

Dean Folkvord, General Manager,
Wheat Montana Farms and Bakery

Three Forks

Nora Gerrity, M.D., Great Falls Clinic

Great Falls

Larry Gianchetta, Dean, School of Business,
University of Montana,

Missoula

Chase Hibbard, President, Sieben Live Stock Co.

Helena

Richard "Rick" Hill, Proprietor, Hill Properties

Helena

Frederick "Fred" Hirschy, Owner, Big Hole Ranch

Jackson

John Olson, President and CEO,

Blue Rock Products Co.

Sidney

Russell "Russ" Ritter, Ritter and Associates

Helena

SENIOR LEADERSHIP

Sherry L. Cladouhos, President and CEO

Terry B. Cosgrove, Executive VP and
General Counsel

Tanya M. Ask, VP, Government Affairs

Sheldon C. Boe, VP, Information Services

Mark A. Burzynski, VP, Health Affairs

Randal C. Cline, Senior VP External Operations

Jane M. DeLong, VP, Strategic Planning and

Corporate Program Management

Michael E. Frank, VP Corporate Integrity
and Compliance Officer

Marianne K. Krpan, VP, Member Services
and Support

Richard S. Miltenberger, Senior Director,
Underwriting

Kirk A. Smith, VP, and Chief Actuary

James A. Vanvig, Assistant VP, Actuarial

Michael S. Wagner, Acting Chief Financial Officer,
VP Government Programs

WE SERVE THOUSANDS OF MONTANANS

We serve more than 230,000 customers across the state. Under a contract with the Centers for Medicare and Medicaid Services (CMS), BCBSMT also administers Medicare Part A (hospital) and Part B (medical professional) for over 150,000 Montana senior citizens.

WE ARE A MAJOR MONTANA EMPLOYER

Blue Cross and Blue Shield of Montana is one of Montana's largest private employers with 700 employees in Billings, Bozeman, Butte, Great Falls, Helena, Kalispell, and Missoula.



PARTNERING WITH MONTANA ORGANIZATIONS

Blue Cross and Blue Shield of Montana (BCBSMT) is committed to improving the health of all Montanans. We also support Montana organizations that have the same goal.

Through the BCBSMT Corporate Contributions and Sponsorship Program, qualifying non-profit organizations are encouraged to request financial support from us for specific health-related programs and events that may have a positive impact on health issues facing Montanans. This program also supports civic and community projects and programs that preserve and enhance the quality of life within the communities we serve.

In 2005, we partnered with:

- American Red Cross—Katrina Fund
- American Cancer Society—Relay for Life
- American Heart Association—Heart Walk
- Caring Foundation of Montana
- Florence Crittenton Home and Services
- Helena Indian Alliance
- Intermountain Children's Home
- Kay McKenna Youth Foundation
- Montana Council Boy Scouts of America
- Montana High School Business Challenge
- Montana Senior Olympics
- Montana Special Olympics
- Mountain Pacific Quality Health Foundation
- Montana Health Research & Education Foundation
- NAMI Montana
- Shodair Children's Hospital
- United Way

STATEWIDE OFFICES

Corporate Headquarters

Helena
560 North Park Avenue
PO Box 4309, Helena, MT 59604
(406) 444-8200 | 1-800-447-7828

District Offices

Billings
2180 Overland
PO Box 80826, Billings, MT 59108
(406) 656-2828

Bozeman
702 North 19th Avenue
PO Box 326, Bozeman, MT 59718
(406) 586-6524

Butte
44 West Park Street
PO Box 766, Butte, MT 59703
(406) 723-5401

Great Falls
3360 Tenth Avenue South
PO Box 5004, Great Falls, MT 59403
(406) 791-4000

Kalispell
240 West Idaho
PO Box 8180, Kalispell, MT 59904
(406) 752-6367

Missoula
2925 Palmer, Suite B,
Missoula, MT 59802
(406) 549-2845

Subsidiaries

Combined Benefits Management, Inc.
560 North Park Avenue, Helena, MT 59601
(406) 444-8267 | Terry B. Cosgrove, President/CEO

Health-e-Web
340 North Last Chance Gulch, Helena, MT 59624
(406) 444-8328 | Robert Janicek, President

Western States Insurance, Inc.
2925 Palmer Street, Suite B, Missoula, MT 59801
(406) 327-6400 | Bruce Mihelish, President/CEO

Combined Benefits Insurance Company, Inc.
560 North Park Avenue, Helena, MT 59601
(406) 444-8267 | Terry B. Cosgrove, President/CEO

Insurance Coordinators of Montana, Inc.
39 Neill Avenue, Helena, MT 59601
(406) 449-9777 | Rich Nelson, President/CEO